



# NATIONAL EXAM PROGRAM

## RISK ALERT

By the Office of Compliance Inspections and Examinations<sup>1</sup>

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### **In this Alert:**

**Topic:** Staff observations from examinations of Municipal Advisors

**Key Takeaways:** Municipal Advisors should take steps to educate themselves regarding their compliance obligations. Exam staff frequently observed deficiencies in MA compliance with regulatory obligations regarding registration, recordkeeping, and supervision.

## OBSERVATIONS FROM MUNICIPAL ADVISOR EXAMINATIONS

### I. INTRODUCTION

In 2014, the Office of Compliance Inspections and Examinations (“OCIE” or “staff”) launched the Municipal Advisor (“MA”) Examination Initiative to conduct examinations of newly registered MAs.<sup>2</sup> During the initiative, the staff conducted over 110 examinations of MAs. OCIE is issuing this Risk Alert to share the staff’s observations from these examinations and to raise awareness of the compliance issues observed by the staff. In sum, the staff observed that MAs were generally unfamiliar with many of their regulatory obligations. Examiners frequently observed deficiencies related to MA compliance with regulatory obligations regarding registration, recordkeeping, and supervision, as more fully described below.

### II. BACKGROUND

Prior to the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”),<sup>3</sup> the activities of MAs were largely unregulated, and MAs were generally not required to register with the Commission or any other federal, state, or self-regulatory entity with respect to their municipal advisory

<sup>1</sup> The views expressed herein are those of the staff of the Office of Compliance Inspections and Examinations, in coordination with other staff of the Securities and Exchange Commission (“SEC” or “Commission”). The Commission has expressed no view on the contents of this Risk Alert. This document was prepared by SEC staff and is not legal advice.

<sup>2</sup> See Letter dated August 19, 2014 to Senior Executive or Principal of a Newly Registered Municipal Advisor from Kevin W. Goodman, National Associate Director, OCIE’s Broker-Dealer Examination Program, available at <https://www.sec.gov/about/offices/ocie/muni-advisor-letter-081914.pdf>. These exams were conducted during 2014 and 2015.

<sup>3</sup> [The Dodd-Frank Wall Street Reform and Consumer Protection Act](#), Pub. L. No. 111-203, 124 Stat. 1376 (2010).

activities.<sup>4</sup> Section 975 of Title IX of the Dodd-Frank Act required MAs to register with the Commission as of October 1, 2010.<sup>5</sup> To enable MAs to meet this requirement, in September 2010, the Commission adopted, and subsequently extended, an interim temporary registration regime.<sup>6</sup> On September 20, 2013, the Commission adopted final MA registration rules, which became effective on July 1, 2014. Under the final MA registration rules, MAs are required to register with the Commission using the final registration forms.<sup>7</sup> In addition, the Dodd-Frank Act granted the Municipal Securities Rulemaking Board (MSRB) regulatory authority over MAs<sup>8</sup> and imposed a fiduciary duty on MAs when advising municipal entities.<sup>9</sup>

### III. EXAMINATIONS

As noted above, the staff conducted over 110 examinations of MAs. The examinations evaluated compliance with regulatory obligations including registration, statutory fiduciary standard of care, fair dealing, recordkeeping, and supervision, among other things. Examiners most frequently observed deficiencies in the areas of registration, books and records, and supervision, as more fully described below. Some firms were referred to the Commission's Division of Enforcement.<sup>10</sup>

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<sup>4</sup> See [Registration of Municipal Advisors](#), Exchange Act Release No. 70462 (September 20, 2013), 78 FR 67468 at 67472 (November 12, 2013) (“Adopting Release”). Engaging in municipal advisory activities means providing advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such financial products or the issues; or undertaking a solicitation of a municipal entity or obligated person (“MA Activities”). See Securities Exchange Act of 1934 (“Exchange Act”) Rule 15Ba1-1(d)(1).

<sup>5</sup> See Section 975(a)(1)(B) of the Dodd-Frank Act; 15 U.S.C. 78o-4(a)(1)(B).

<sup>6</sup> See Exchange Act Rule 15Ba2-6T, 17 CFR 240.15Ba2-6T and Form MA-T. See also [Temporary Registration of Municipal Advisors](#), Exchange Act Release No. 62824 (Sept. 1, 2010), 75 FR 54465 (Sept. 8, 2010). See also [Adopting Release](#), 78 FR at 67476 (noting that the Commission extended the expiration date of the temporary registration regime on December 21, 2011, September 21, 2012, and November 12, 2013).

<sup>7</sup> See Exchange Act Rules 15Ba1-1 through 15Ba1-8, 15Bc4-1, and Forms MA, MA-I, MA-W, and MA-NR and [Adopting Release](#), 78 FR 67468 at 67581-67583 (establishing January 13, 2014 as the effective date and providing for a phased-in compliance period); but see [Temporary Stay of Final Rule on Registration of Municipal Advisors](#), Exchange Act Release No. 71288 (January 13, 2014), 79 FR 2777 (January 16, 2014) (instituting temporary stay of final rules until July 1, 2014).

<sup>8</sup> See 15 U.S.C. 78o-4(b).

<sup>9</sup> See 15 U.S.C. 78o-4(c). Specifically, Exchange Act Section 15B(c)(1) provides that: “A municipal advisor and any person associated with such municipal advisor shall be deemed to have a fiduciary duty to any municipal entity for whom such municipal advisor acts as a municipal advisor, and no municipal advisor may engage in any act, practice, or course of business which is not consistent with a municipal advisor’s fiduciary duty or that is in contravention of any rule of the Board.” 15 U.S.C. 78o-4(c)(1).

<sup>10</sup> See, e.g., [In the Matter of Central States Capital Markets, LLC; Mark R. Detter; David K. Malone; and John D. Stepp](#), Exchange Act Release No. 77369 (Mar. 15, 2016) (settled action charging MA for breaching its fiduciary obligation by failing to disclose a conflict of interest to a municipal client) and associated Press Release, “[Municipal Advisor Charged for Failing to Disclose Conflict](#) (Mar. 15, 2016) at <https://www.sec.gov/news/pressrelease/2016-54.html>.

**A. Registration**

The Commission’s registration regime for MAs involves four forms: Form MA, Form MA-I, Form MA-NR, and Form MA-W.

- **Form MA: Application for Municipal Advisor Registration.** An entity that seeks to engage in MA Activities must register with the Commission using Form MA. An MA must file an annual update to Form MA within 90 days after the end of its fiscal year. An MA also must promptly file an amendment to Form MA whenever a material event has occurred that changes the information previously provided in the Form MA.
- **Form MA-I: Information Regarding Natural Persons Who Engage in Municipal Advisory Activities.** An MA must complete and file a Form MA-I for each natural person associated with the firm that is engaged in MA Activities on the firm’s behalf (i.e., an associated person). An MA must promptly file an amendment to Form MA-I whenever the information previously provided becomes inaccurate.
- **Form MA-NR: Designation of U.S. Agent for Service of Process for Non-Residents.** Each non-resident MA, non-resident general partner or non-resident managing agent of an MA, and non-resident natural person associated with an MA that is engaged in MA Activities on behalf of the MA must execute a written irrevocable consent and power of attorney on Form MA-NR to appoint an agent in the United States for service of process.
- **Form MA-W: Notice of Withdrawal from Registration as a Municipal Advisor.** An entity that is registered as an MA, but is no longer required to be registered as an MA (e.g., because it is no longer engaging in MA Activities), must file a Form MA-W to withdraw its registration.<sup>11</sup>

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**MA Registration  
Quick Reference Tool**

**Initial Registration:** Use Form MA, Form MA-I, MSRB Form A-12, and, if necessary, Form MA-NR

**Maintaining Registration:** Use Form MA for annual updates and amendments and Form MA-I for amendments

**Withdrawing Registration:** Use Form MA-W, withdraw MSRB Form A-12, and amend Form MA-I

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After registering with the Commission, MAs must register with the MSRB on MSRB Form A-12 before engaging in MA Activities.

- **MSRB Form A-12:** To register with the MSRB, an MA must have a permanent SEC registration number and must provide this number and other registration information to the MSRB by completing MSRB Form A-12. MSRB Form A-12 must be affirmed annually and also updated within 30 days if any

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<sup>11</sup> An MA withdrawing its registration must file an amended Form MA-I for each of its associated persons to indicate that they are no longer associated with the MA.

information therein becomes inaccurate or if the MA ceases to be engaged in MA Activities.<sup>12</sup> [MSRB Rule A-12](#) requires MAs to pay an initial fee of \$1,000 and an annual fee of \$1,000.<sup>13</sup>

During examinations, the staff frequently observed the following types of registration deficiencies:

- Failure to register with the Commission or the MSRB prior to engaging in MA Activities;
- Failure to file annual updates to Form MA;
- Failure to file amendments to Form MA, Form MA-I, and MSRB Form A-12 when required;
- Failure to complete Form MA with accurate and complete information, particularly with respect to compensation arrangements and outside business activities;
- Failure to pay MSRB registration fees and late fees; and
- Failure to file a Form MA-W and withdraw MSRB Form A-12 when withdrawing from MA registration.<sup>14</sup>

### ***B. Books and Records***

Exchange Act Rule 15Ba1-8 requires MAs to make and keep certain books and records. Specifically, the rule requires MAs to make and keep true, accurate, and current the following types of records relating to their MA Activities:

- Originals or copies of all written communications received or sent by the MA relating to MA Activities, regardless of the format of such communications;
- All check books, bank statements, general ledgers, cancelled checks, and cash reconciliations;
- A copy of each version of the MA's policies and procedures that are currently in effect or were in effect at any time during the last five years (not including those in effect prior to July 1, 2014);
- A copy of any document created by the MA that was material to making a recommendation to a municipal entity or obligated person<sup>15</sup> or that memorializes the basis for the recommendation;
- All written agreements (or copies thereof) entered into by the MA with any municipal entity, employee of a municipal entity, or obligated person or otherwise relating to the business of the MA;

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<sup>12</sup> See [MSRB Rule A-12](#).

<sup>13</sup> *Id.*

<sup>14</sup> An MA withdrawing its registration must also file an amended Form MA-I for each of its associated persons to indicate that they are no longer associated with the MA.

<sup>15</sup> Exchange Act Rule 15Ba1-1(k) defines the term "obligated person" as any person, including an issuer of municipal securities, who is either generally or through an enterprise, fund, or account of such person, committed by contract or other arrangement to support the payment of all or part of the obligations on the municipal securities to be sold in an offering of municipal securities, however, the term "obligated person" does not include (1) a person who provides municipal bond insurance, letters of credit, or other liquidity facilities; (2) a person whose financial information or operating data is not material to a municipal securities offering, without reference to any municipal bond insurance, letter of credit, liquidity facility, or other credit enhancement; or (3) the federal government.

- A record of the names of persons who are currently, or within the past five years were, associated with the MA (not including persons associated with the MA prior to July 1, 2014);
- A list or other record containing the following:
  - Names, titles, business address, and residential address of all persons associated with the MA;
  - All municipal entities or obligated persons with which the MA is engaged, or has engaged in, MA Activities in the past five years (not including those prior to July 1, 2014);
  - The name and business address of each person to whom the MA provides, or agrees to provide, directly or indirectly, payment to solicit a municipal entity, an employee of a municipal entity, or an obligated person on its behalf; and
  - The name and business address of each person that provides, or agrees to provide, directly or indirectly, payment to the MA to solicit a municipal entity, an employee of a municipal entity, or an obligated person on its behalf; and
- Written consents to service of process from each natural person associated with the MA that is engaged in MA Activities on behalf of the MA.

During examinations, the staff frequently observed the following types of recordkeeping deficiencies:

- Failure to maintain copies of written communications sent or received by the firm related to MA Activities, including those sent electronically;
- Failure to make and keep documents material to a recommendation made to a client;
- Failure to prepare and maintain accurate general ledgers. For example, the staff often observed that MAs' general ledgers did not accurately reflect assets, liabilities, reserves, capital, and income and expense accounts; and
- Failure to maintain accurate records of cash receipts and disbursements.

### *C. Supervision*

[MSRB Rule G-44](#) requires MAs to establish, implement, and maintain a system to supervise the MA Activities of the firm and its associated persons that is reasonably designed to achieve compliance with all applicable securities laws and regulations, including applicable MSRB rules (“applicable rules”). An MA’s supervisory system must provide for (1) the establishment, implementation, maintenance, and enforcement of written supervisory procedures (“WSPs”) that are reasonably designed to achieve compliance with all applicable rules, and (2) the designation of one or more municipal advisory principals to be responsible for supervision. [MSRB Rule G-44](#) also requires each MA to designate an individual to serve as its chief compliance officer.

During examinations, the staff frequently observed the following types of supervisory deficiencies:

- Failure to have a system to supervise the MA Activities of employees that was reasonably designed to achieve compliance with all applicable rules;

- Failure to monitor gifts, travel, and entertainment expenses, including the failure to maintain accurate records of travel and entertainment expenses either indexed or capable of being searched by recipient;<sup>16</sup>
- Failure to oversee the firm's responses to requests for proposals;
- Failure to have WSPs reasonably designed to ensure compliance with applicable rules;
  - Failure to tailor WSPs to the firm's business activities and conflicts of interest; and
- Failure to designate one or more principals to be responsible for supervisory activities.

#### IV. CONCLUSION

In sharing the observations from these examinations, OCIE hopes to encourage MAs to reflect upon their practices, policies, and procedures in these areas and to make any necessary improvements. Staff also reminds MAs that they must also comply with any new rules that have become effective, such as those adopted by the MSRB.

The staff welcomes comments and suggestions about how the Commission's examination program can better fulfill its mission to improve compliance, prevent fraud, monitor risk, and inform SEC policy. If you suspect or observe activity that may violate the federal securities laws or otherwise operates to harm investors, please notify us at [http://www.sec.gov/complaint/info\\_tipscomplaint.shtml](http://www.sec.gov/complaint/info_tipscomplaint.shtml).

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*This Risk Alert is intended to highlight for firms risks and issues that the staff has identified. In addition, this Risk Alert describes risks that firms may consider to (i) assess their supervisory, compliance, and/or other risk management systems related to these risks, and (ii) make any changes, as may be appropriate, to address or strengthen such systems. Other risks besides those described in this Risk Alert may be appropriate to consider, and some risks described in this Risk Alert may not be applicable to a particular firm's business. Future changes in laws or regulations may supersede some of the risks or issues discussed in this Risk Alert. The adequacy of supervisory, compliance, and other risk management systems can be determined only with reference to the profile of each specific firm and other facts and circumstances.*

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<sup>16</sup> See e.g., [MSRB Rule G-20](#).